

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2765

AUDIT REPORT
OF
INDIANA DEPARTMENT OF REVENUE
STATE OF INDIANA
July 1, 2002 to June 30, 2003

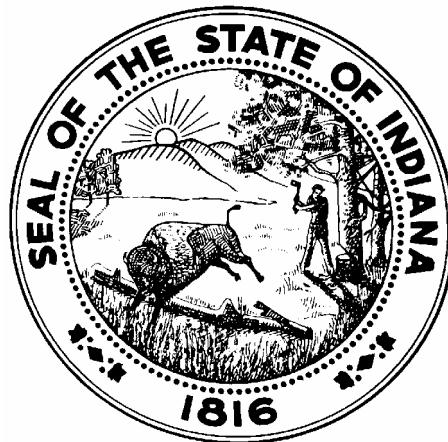


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AGENCY OFFICIAL

Office

Official

Term

Commissioner

Mr. Kenneth Miller

01-09-01 to 01-10-05



STATE OF INDIANA

AN EQUAL OPPORTUNITY EMPLOYER

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TO: THE OFFICIALS OF THE INDIANA DEPARTMENT OF REVENUE

We have audited the records of the Indiana Department of Revenue, for the period July 1, 2002, to June 30, 2003, and certify that the records and accountability for cash and other assets are satisfactory to the best of our knowledge and belief except as stated in the Audit Results and Comments. The financial transactions of this office are reflected in the Indiana Comprehensive Annual Financial Reports.

STATE BOARD OF ACCOUNTS

December 16, 2003

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2003

WITHHOLDING RECONCILIATION

As stated in previous audit reports (most recently B20208 and B18309), the Department of Revenue's internal controls over the reconciliation of income tax withholding did not guarantee that adequate compliance was being maintained. Controls are still inadequate and would allow discrepancies to remain undetected.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements, and incorrect decision making. An agency's control environment consists of the overall attitude, awareness and actions of management and the governing board or commission. This would include establishing and monitoring policies for developing and modifying accounting systems and control procedures. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 5)

SALES TAX COLLECTED FROM OTHER AGENCIES

Introduction

A number of state agencies other than the Department of Revenue (Department) collect gross retail and use taxes throughout the month and deposit the funds into the Department's sales tax fund center. At the beginning of the following month, the Controller's Division (Division) transfers those collections into the General, Property Tax Replacement, Public Mass Transportation, Industrial Rail, and Commuter Rail fund/centers by percentages stated in IC 6-2.5-10-1. Transfer percentages are calculated using formulas the Division has entered into their computer spreadsheet.

Incorrect Transfer Percentages

During the audit, we found that the Division had not modified the formulas to reflect the new percentages changed by statute effective January 1, 2003. This was due to inadequate procedures to verify that all statute changes are properly implemented. As a result, sales tax collections from other state agencies from January 1 through June 30 were not transferred correctly to the designated funds. The General fund was over funded by \$5,437,830.87, the Property Tax Replacement fund was under funded by \$5,527,374.03, the Public Mass Transportation fund was over funded by \$69,092.18, the Industrial Rail fund was over funded by \$75,725.03, and the Commuter Rail fund was under funded by \$55,273.74. On November 17, 2003, the Division submitted a journal voucher to the Auditor of State to resolve the above error.

Indiana Code 6-2.5-10-1 states, in part, that "The department shall account for all state gross retail and use taxes that it collects and shall deposit those collections in the following manner . . ."

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2003
(Continued)

Each agency, department, institution or office is responsible for compliance with applicable statutes, regulations, contract provisions, state policies, and federal requirements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

Controls over the receipting, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions and inaccurate records and financial statements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 3)

The agency has the responsibility for recording and submitting documents prepared as input to the Auditor of State's accounting system. The proper utilization of the state system includes the objectives of: timely submission of documents; proper classification of the transaction; recording of accurate amounts; and verification of correct posting to reports. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

SUSPENSE ACCOUNT – NO STATUTORY AUTHORITY

The Suspense system is a computer database maintained by the Controller's Division for the purpose of holding taxpayer check payments paid to the Department that cannot be initially identified into which fund/center the funds should be applied. Initially, these payments are deposited into a local depository account and a new file is created in the Suspense system. Once the tax has been identified through additional information obtained from the taxpayer, a check is written from the account and the Suspense system file is closed. Checks are made payable to the Department, to another state agency, or are refunded to the taxpayer.

We found no statutory authority for the Department to deposit public funds in a local bank account without authorization from the Treasurer of State or to expend public funds without the statutory oversight of the Auditor of State.

Per IC 4-13-2-7, the Auditor of State shall: “. . . Examine every receipt, account, bill, claim, refund, and demand against the state arising from activities carried on by agencies of the state, approve each legal, correct, and proper claim, designate the account to be charged therefore, and issue the auditor's warrant in payment thereof.”

Per IC 5-13-6-1, “. . . all public funds collected by state officers, other than the treasurer of state, shall be deposited with the treasurer of state, or an approved depository selected by the treasurer of state no later than the business day following the receipt of funds.”

Each agency, department, institution or office is responsible for compliance with applicable statutes, regulations, contract provisions, state policies, and federal requirements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INTERNAL CONTROLS OVER DISTRICT OFFICE ACCOUNTS

The Department has district offices located throughout the state that collect tax revenue. Each office has a local depository account in the name of the Department for deposit of funds and sends its financial activity to the Controller's Division daily. Once a month the Division transfers the prior month's collections from the local bank to the Treasurer of State.

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2003
(Continued)

During our audit, we found that the Division does not initiate the transfers until after district office bank account reconciliations are completed. Therefore, monies collected at the beginning of the month will remain at the local bank for up to six weeks before transfer to the Treasurer. Funds at the local bank earn no interest. The delay in transfer of funds results in a loss of revenue to the General Fund.

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INVESTMENTS – NO STATUTORY AUTHORITY

We found that funds deposited at one district office bank were used for investment purposes. The Controller's Division at Central office initiated these investment activities and monitored activity through monthly depository account reconciliations. Although the Department did receive interest on this investment, they also paid client analysis service fees. The account was reverted back to a non-investment checking account as of March, 2003, when the monthly service fee charge was almost as much as the interest earned.

We found no statutory authority for the Department to invest state funds.

Per IC 5-13-10.5-2, “. . . (1) the treasurer of state, under the guidelines established by the state board of finance; and (2) any other public officer of the state authorized by statute or court order to make investments; may invest or reinvest funds held by the treasurer of state or other public officer in any combination of the investments authorized under this chapter”.

INTERNAL CONTROLS OVER REVENUE – UNABLE TO DETERMINE DATE OF RECEIPT

To evaluate the timeliness of deposits, we consider the date stamped on the return to be the date of receipt unless the return is processed through the RPS system. During our audit of tax returns not processed through the RPS system, we found tax returns that were not date stamped. As a result, we could not evaluate for timeliness of deposits. This includes, but may not be limited to, tax returns for Other Tobacco Products, IFTA/MC mail-ins at JFK, and Charity Gaming Excise.

Indiana Code 5-13-5-1(a) states: "Every public official who receives or distributes public funds shall: (1) keep a cash book into which the public officer shall enter daily, by item, all receipts of public funds; and (2) balance the cash book daily to show funds on hand at the close of the day."

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
June 30, 2003
(Continued)

INTERNAL CONTROLS OVER IFTA/MC REVENUE

Introduction

International Fuel Tax Agreement (IFTA) and Intrastate Motor Carrier (MC) tax revenues are generated from operating qualified motor vehicles, primarily trucks, on any highway in the state. The Department collects revenue through licensure, annual renewals, and taxes based on the number of miles traveled and gallons of fuel consumed. Most mail-in returns are processed through the RPS system at the Logan building. All walk-ins and some mail-ins are processed at the Motor Carrier Services Division at the JFK building. These are not processed through the RPS system.

Ineffective Batch Processing

For tax revenue processed through the RPS system, the submitted returns are batched into a specified item count and the accompanying checks totaled for deposit. Every batch is to be opened and closed in the same day allowing connectivity between the batched returns and total revenue received. The batch date will coincide with the deposit date for each return.

This is not the case for batches used for the IFTA/MC revenue processed at the Motor Carrier Services Division. These batches are opened weekly and may remain open for days or weeks. The batch date has no correlation to the deposit date. Due to insufficient documentation attached to some of the batches, it is difficult to verify that the revenue received with the batched returns has been deposited. During our testing, it took several days for the IFTA/MC Division to ascertain when checks for specific returns had been deposited.

The Department does not have adequate documentation procedures for batches processed outside the RPS system.

Controls over the receipting, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions and inaccurate records and financial statements. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 3)

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

INTERNAL CONTROLS OVER PUBLIC UTILITY TAX REVENUE

Introduction

The Department of Local Government Finance imposes a tax on companies who meet the criteria as described in IC 6-1.1-8-3 and forwards the information to the Department of Revenue. The Controller's Division at the Department of Revenue creates the tax liability invoices to be mailed and records

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
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(Continued)

the payments to the taxpayers' account on their Commuter Rail system upon receipt. Tax payments are due by each December 31. At the beginning of the following calendar year, the Division generates an outstanding list of taxpayers who have failed to pay their yearly taxes and forwards the list to the Collection's Division.

Lack of Assessed Penalties of Late Filers

A penalty is to be assessed by the department on tax payments not received or postmarked by the due date. During our audit, we found that numerous taxpayers had not been billed for penalty charges even though the postmark date was subsequent to December 31.

The Department does not have adequate procedures in place to identify and bill for penalties of those taxpayers who submitted payments after the due date.

Lack of Tax Collections of Non-Filers

It is the responsibility of the Collection's Division to submit unpaid tax liabilities into the collection process. During our audit, we discovered that several years of outstanding lists had never been inputted into the Department's collection process on their RPS system.

The Department does not have adequate procedures in place to collect tax liabilities from non-filers.

IC 6-1.1-8-35(b) states, in part, that "If one (1) of those companies does not pay the tax when it is due, the company shall pay a penalty, in addition to the tax, equal to twenty-five (25%) of the delinquent tax. When the tax imposed . . . becomes delinquent, the department of state revenue shall proceed with the collection of the delinquent tax and penalty in accordance with the provisions of IC 6-8.1-8".

Per Indiana Code 6-8.1-6-3(a), "A document, including a form, a return, payment, or a writing of any type, which must be filed with the department by a prescribed date, is considered filed: (1) in cases where it is mailed through the United States mail, on the date displayed on the post office cancellation mark stamped on the document's wrapper . . ."

Each agency, department, institution or office should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are part of an internal control system. (Accounting and Uniform Compliance Guidelines Manual for State Agencies, Chapter 1)

DAILY DEPOSITS

As stated in previous audit reports (most recently B20208 and B18309), the Department did not consistently deposit receipts collected for most tax remittance types by the following business day after receipt of the funds.

INDIANA DEPARTMENT OF REVENUE
AUDIT RESULTS AND COMMENTS
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Indiana Code 5-13-6-1(b) states in part: ". . . all public funds . . . shall be deposited with the treasurer of state, or an approved depository selected by the treasurer of state not later than the business day following the receipt of the funds."

INDIANA DEPARTMENT OF REVENUE
EXIT CONFERENCE

The contents of this report were discussed with Mr. Kenneth Miller, Commissioner, on January 20, 2004. The official response to the audit findings has been made a part of this report and may be found on Pages 11 through 13.



STATE OF INDIANA

DEPARTMENT OF REVENUE OFFICE OF THE COMMISSIONER

Indiana Government Center North
100 North Senate Avenue, Room N248
Indianapolis, Indiana 46204-2253

March 26, 2004

Mr. Charles Johnson, III, State Examiner
State Board of Accounts
Indiana Government Center South
302 W. Washington Street, E418
Indianapolis, IN 46204

Dear Mr. Johnson

Attached please find the Indiana Department of Revenue's official response to the 2003 Audit by the State Board of Accounts. If I can be of further assistance, please contact me at your convenience.

Sincerely

A handwritten signature in black ink, appearing to read "Kenneth L. Miller".

Kenneth L. Miller
Commissioner

Enclosure

Indiana Department of Revenue
Response to 2003 Audit

Withholding Reconciliation

The Department continues to review withholding accounts for validity. Statistical samplings of employers who file magnetic media are being conducted. Efforts to improve the PC-based program for downloading magnetic media are currently under development. Returns identified by the system to be reviewed by a user (PRI) are examined; employer identification numbers are checked for validity and withholding registration.

Meanwhile, the Returns Processing System automatically verifies monthly withholding remittance to the annual withholding reconciliation return. If a discrepancy exists, the account is flagged for a user review.

Sales Tax Collected From Other Agencies

Sales tax changed in December, 2002 and the distribution formulas also changed. The Department changed the formulas for all of the sales tax collected except for sales tax collected from other agencies. The formulas and the adjustments to these accounts were corrected November 17, 2003.

Suspense Account – No Statutory Authority

The Department processed over 4,000,000 checks last year and 476 checks were deposited into the suspense account because we could not determine where to apply them. The Department will close our suspense accounts and disperse these monies using the Auditor of State's and Treasurer of State's accounts for these transactions.

Internal Controls over District Office Accounts

The Department District Offices throughout the State have a local bank account for deposits. Our policy was to sweep the accounts monthly after the account was reconciled. The Department has implemented procedures to transfer the monies from the district office bank accounts more often.

We are in the process of implementing an electronic process that may eliminate the need for a local bank account for the District Offices.

Investments- No statutory Authority

The Department had a checking account at a district office that paid interest. It was the Office's account used to conduct business. As stated in the comment the Department closed this account in March, 2003.

Internal Controls Over Revenue – Unable to Determine Date of Receipt

The areas of concern were centered on Other Tobacco Products and Charity Gaming Excise.

The Department licenses 234 Other Tobacco Products Distributors (OTP) and 156 Cigarette Distributors, many hold both licenses. Some of these Distributors send both of their monthly returns to same address at the same time. OTP monthly reports are supposed to be sent to Returns Processing Center and Cigarette returns to Controllers Division. We will continue to deposit the funds on the date the mail is received.

The Systems Services Section of the Returns Processing Center processes the Charity Gaming Excise Tax returns. As of February, 2004, Charity Gaming Excise batches with checks are closed daily.

Internal Controls over IFTA/MC Revenue

The majority of revenue collected for BAS and IFTA/MC is processed through the RPS system, however some payments are mailed and walked into our office and processed through the Motor Carrier Services Division. Since these transactions are less than the 96 documents that can be processed in a batch, the batches were left open for up to a week. All monies collected are deposited the following day.

As of January 23, 2004, all batches with checks are closed on a daily basis. Every batch is opened and closed in the same day, allowing reconciliation between the batched returns and total revenue received.

Internal Controls over Public Utility Tax Revenue

For this time period, 298 taxpayers were billed and approximately 14 paid late and were not billed a penalty in a timely manner. The Department has billed the late filers a penalty.

Daily Deposits

Each year the Returns Processing Center strives to deposit funds within 24 hours of receipt. During the peak period in April alone, the Department receives approximately one million (1,000,000) returns. Nevertheless, the Department will continue to use as many resources as operationally possible in an effort to meet 100% of funds deposited by the next business day.